
Introduction to
Project Finance
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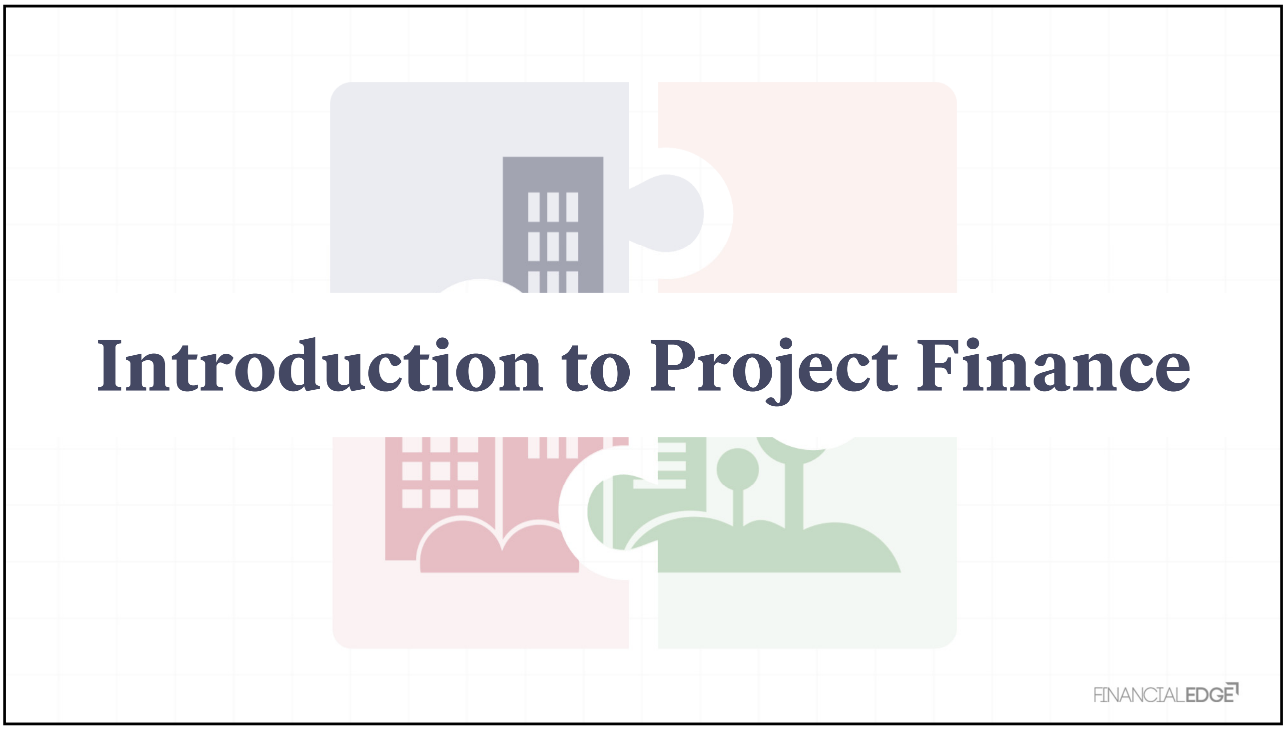
Introduction to Project Finance
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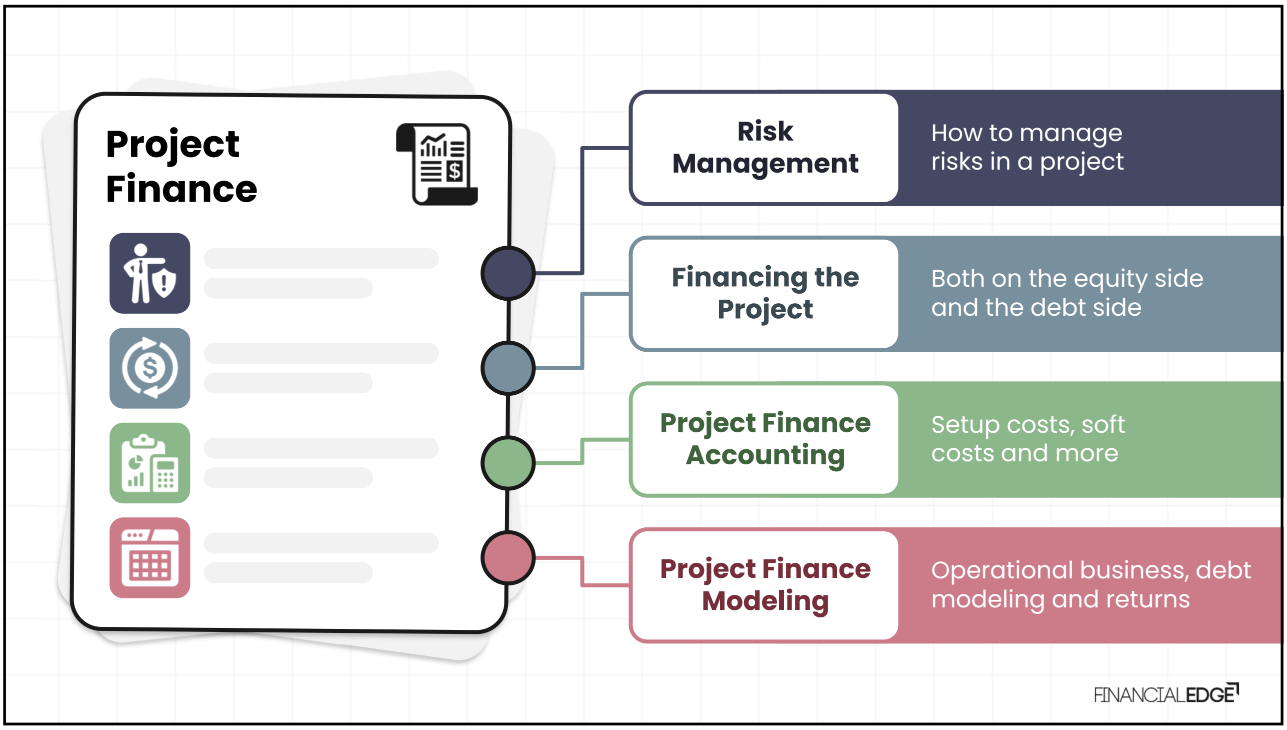
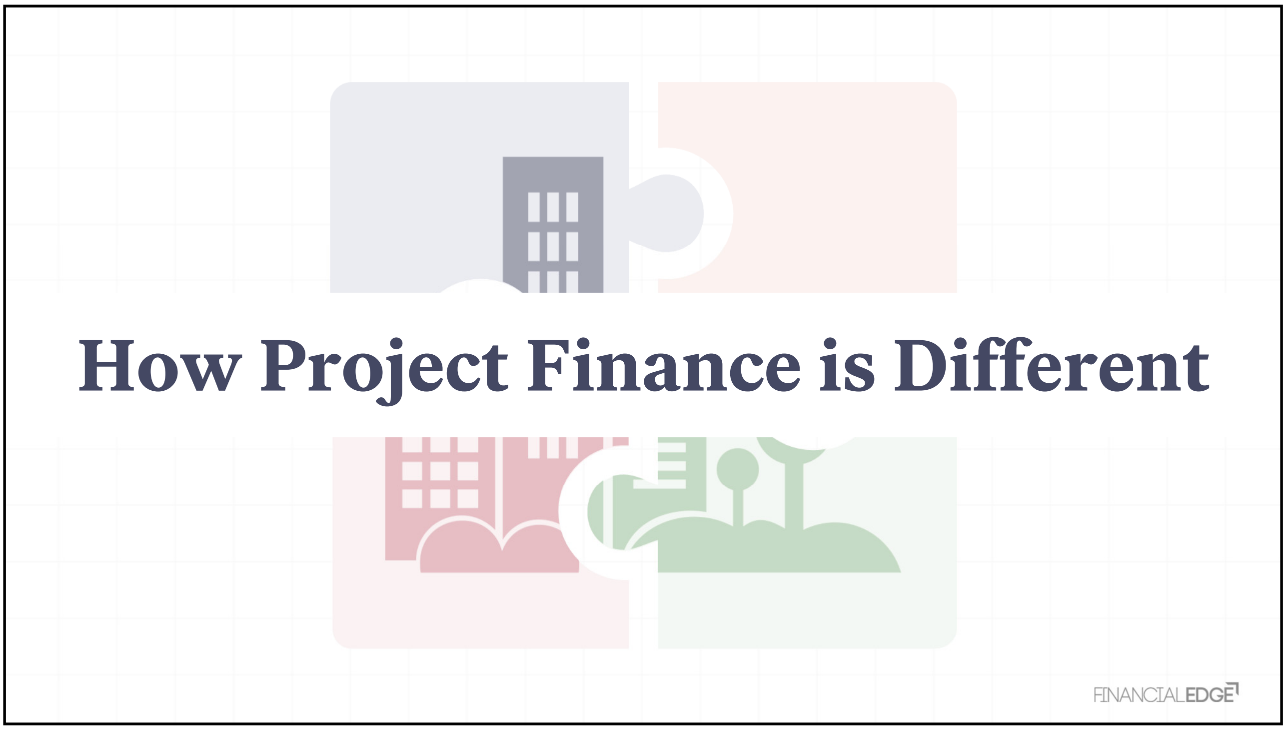
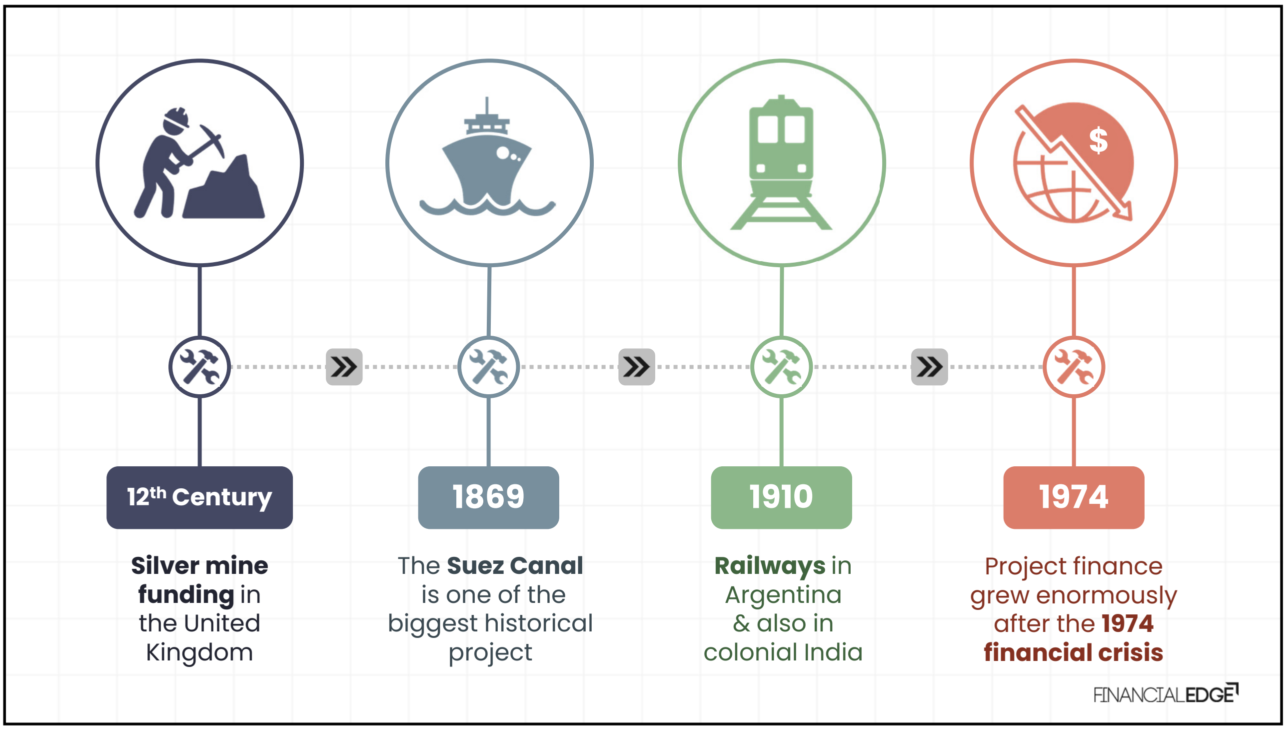

Project Finance
Risk Management
How to manage risks in a project
Financing the Project
Both on the equity side and the debt side
Project Finance Accounting
Setup costs, soft costs and more
Project Finance Modeling
Operational business, debt modeling and returns


How Project Finance is Different


12th Century
Silver mine funding in the United Kingdom
1869
The Suez Canal is one of the biggest historical project
1910
Railways in Argentina & also in colonial India
1974
Project finance grew enormously after the 1974 financial crisis
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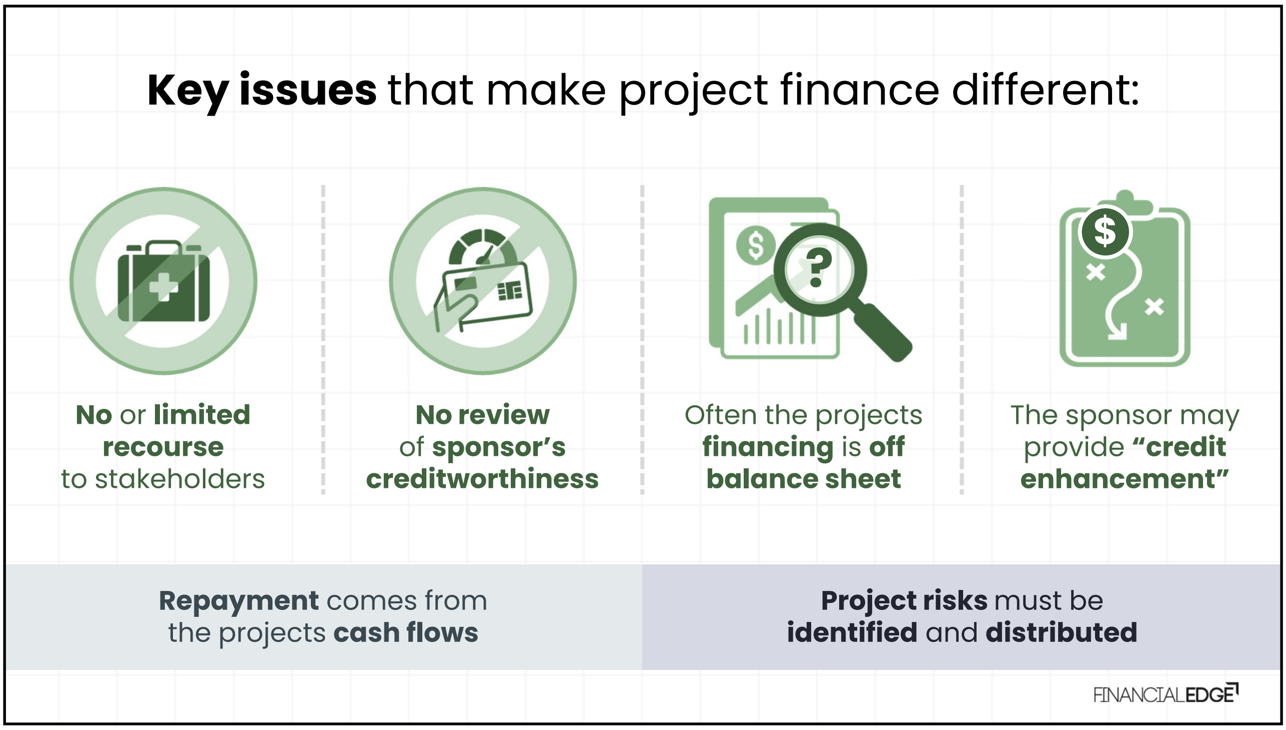
Key issues that make project finance different:
No or limited recourse to stakeholders
No review of sponsor's creditworthiness
Often the projects financing is off balance sheet
The sponsor may provide "credit enhancement"
Repayment comes from the projects cash flows
Project risks must be identified and distributed
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Project Finance
Regular Finance
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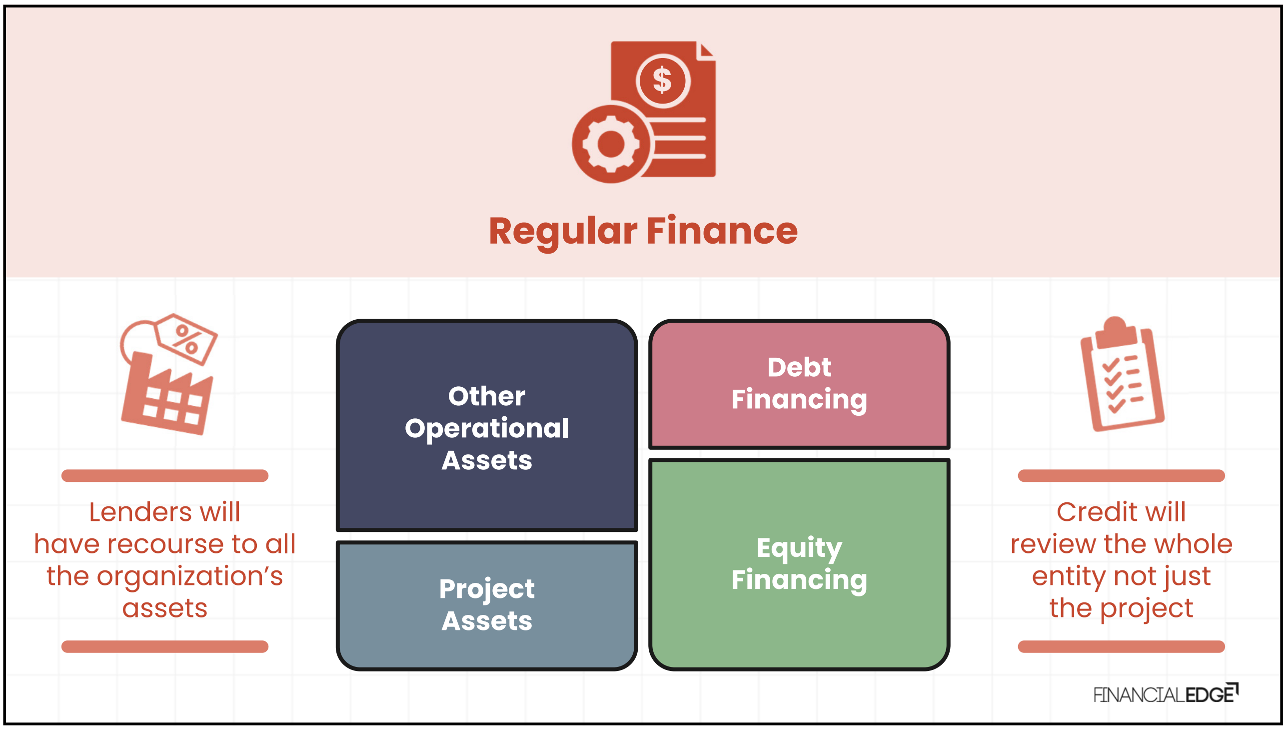
Regular Finance
Lenders will have recourse to all the organization's assets
Other Operational Assets
Project Assets
Debt Financing
Equity Financing
Credit will review the whole entity not just the project
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Project Finance
Regular Finance
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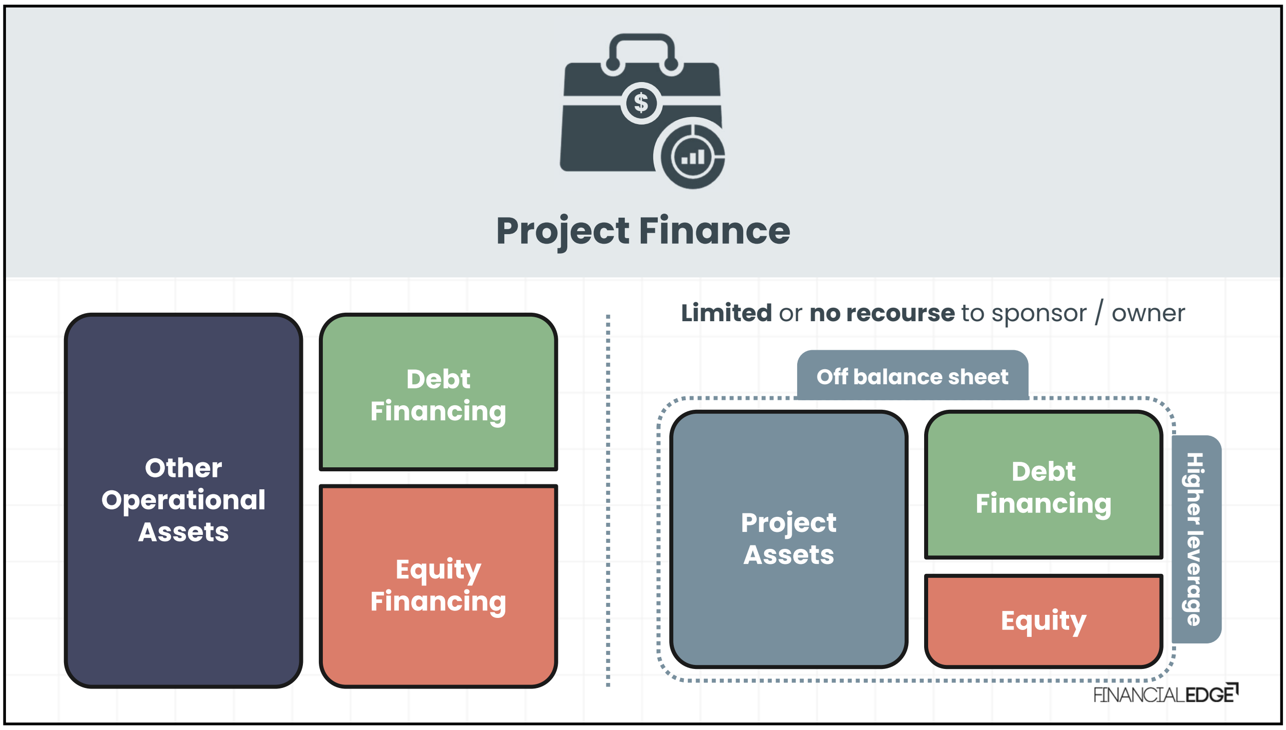
Project Finance
Other Operational Assets
Debt Financing
Equity Financing
Limited or no recourse to sponsor / owner
Off balance sheet
Project Assets
Debt Financing
Equity
Higher leverage
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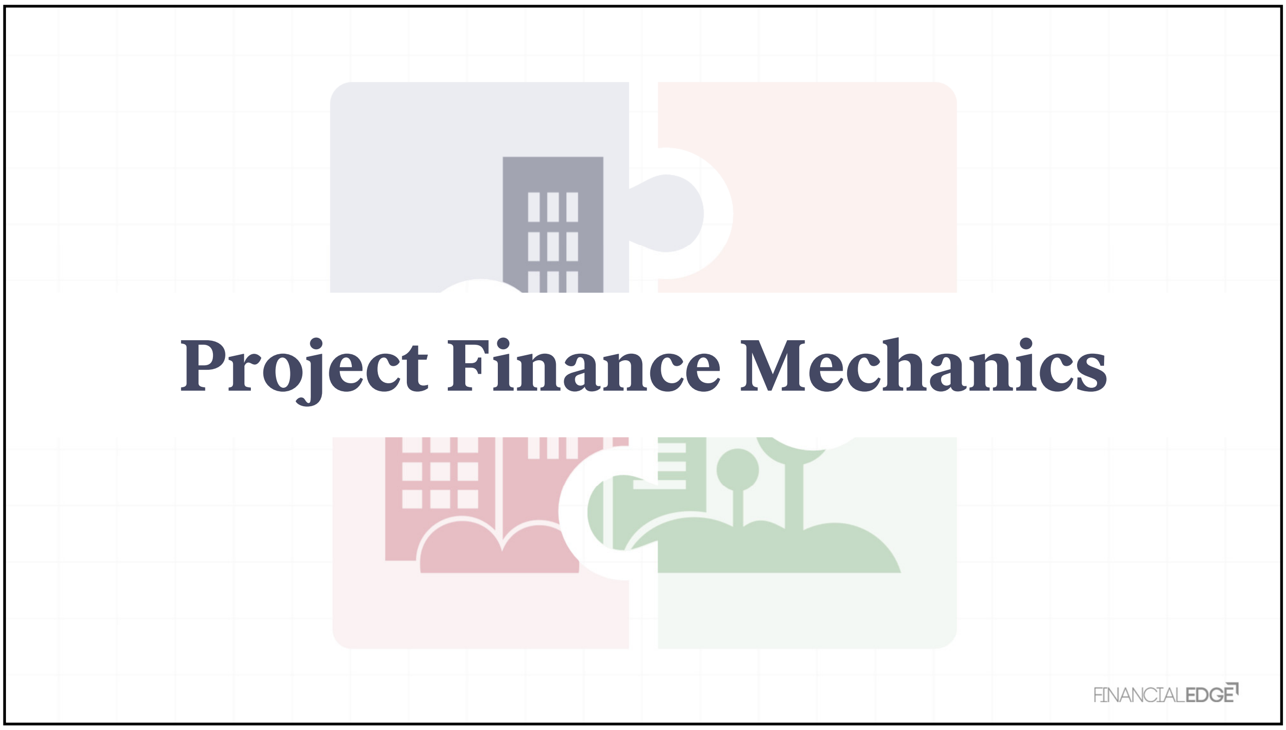
Project Finance Mechanics
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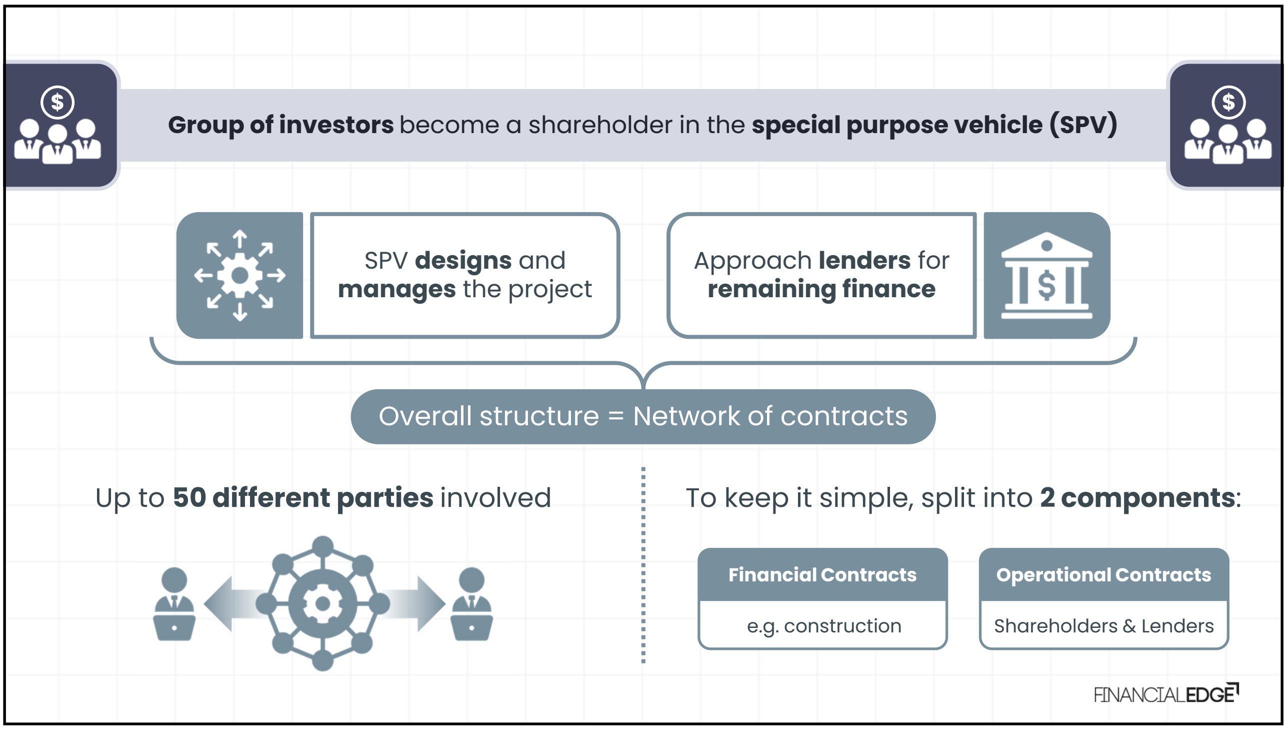
Group of investors become a shareholder in the special purpose vehicle (SPV)
SPV designs and manages the project
Approach lenders for remaining finance
Overall structure = Network of contracts
Up to 50 different parties involved
To keep it simple, split into 2 components:
Financial Contracts
e.g. construction
Operational Contracts
Shareholders & Lenders
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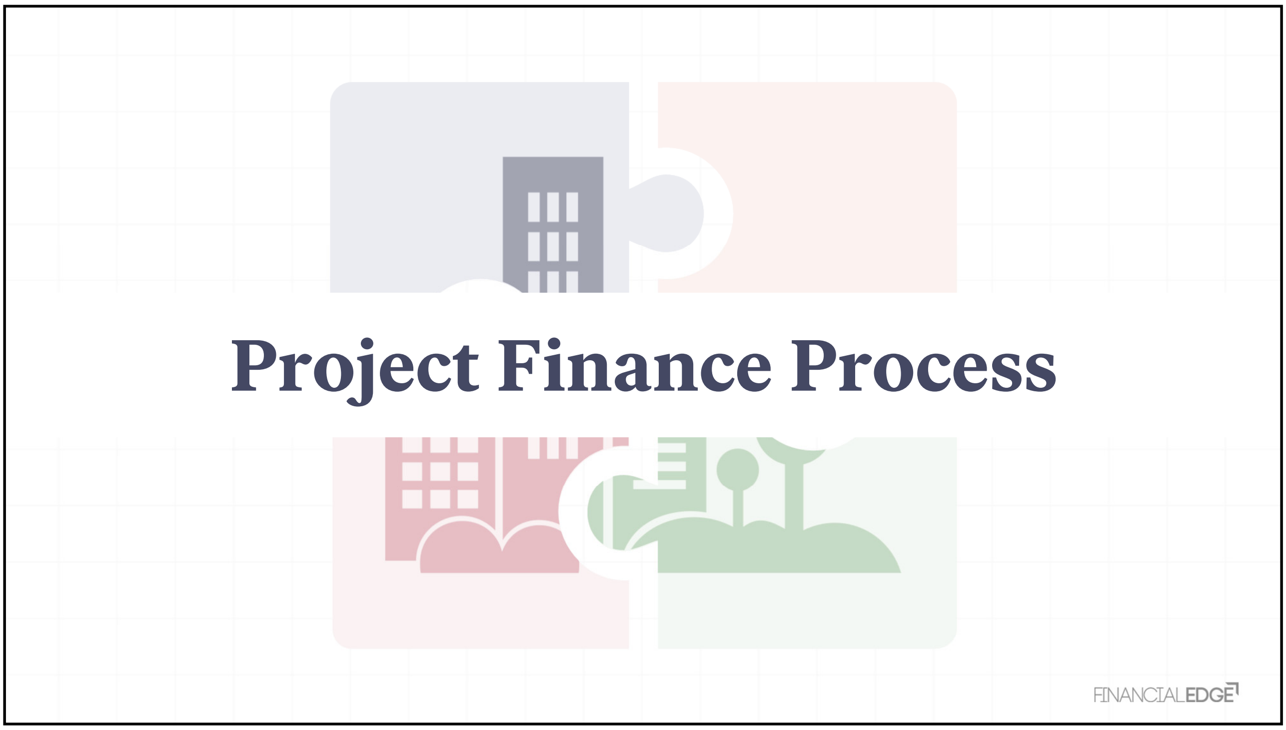
Project Finance Process
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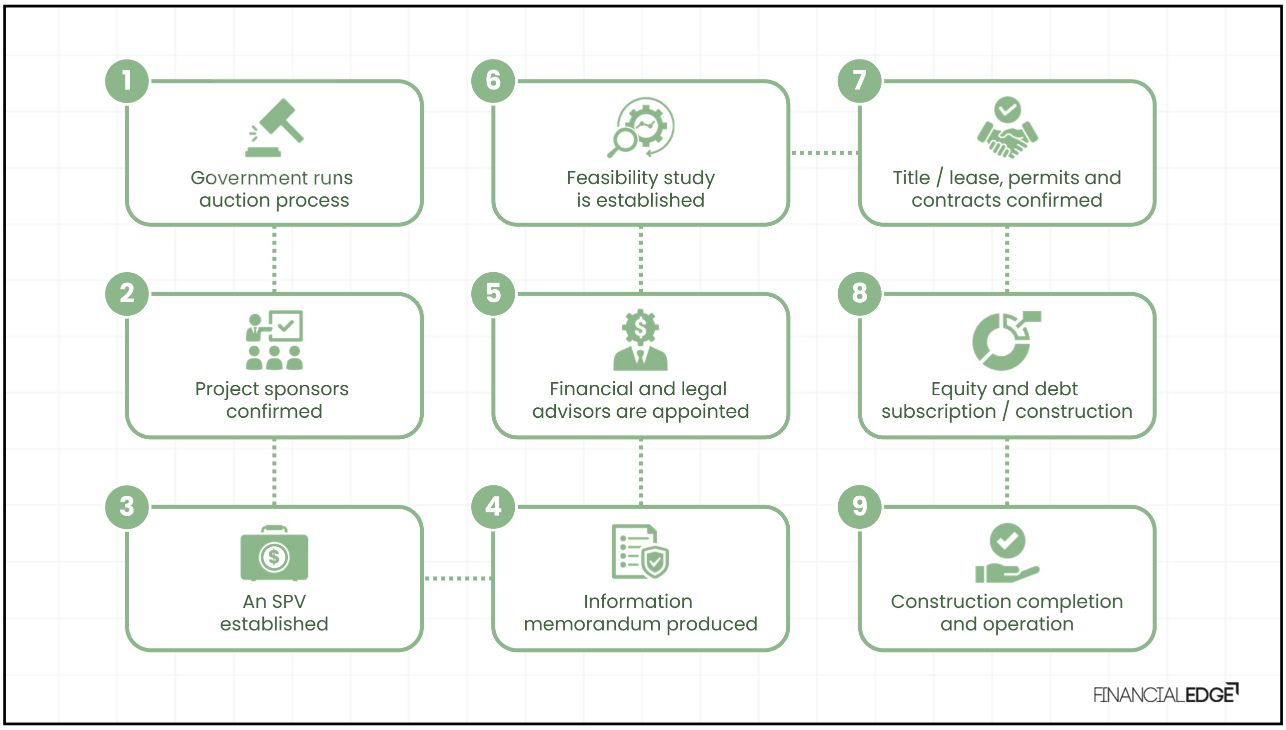
1
Government runs auction process
2
Project sponsors confirmed
3
An SPV established
4
Information memorandum produced
5
Financial and legal advisors are appointed
6
Feasibility study is established
7
Title / lease, permits and contracts confirmed
8
Equity and debt subscription / construction
9
Construction completion and operation
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Contract Summary
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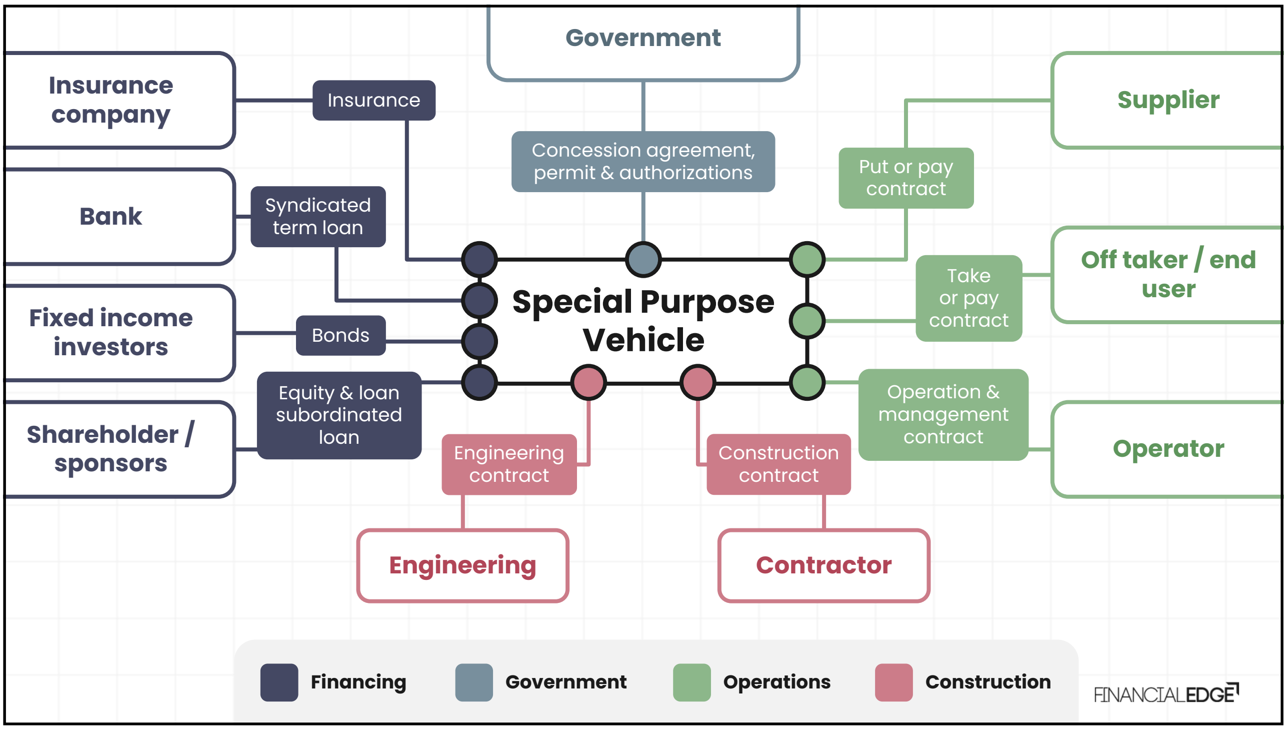
Government
Insurance company
Insurance
Concession agreement, permit & authorizations
Supplier
Put or pay contract
Bank
Syndicated term loan
Special Purpose Vehicle
Take or pay contract
Off taker / end user
Fixed income investors
Bonds
Equity & loan subordinated loan
Operation & management contract
Shareholder / sponsors
Engineering contract
Construction contract
Operator
Engineering
Contractor
Financing
Government
Operations
Construction
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Financial Contracts

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Equity

Equity **contribution agreement** with the project sponsors and the SPV

THREEE CATEGORIES OF EQUITY SPONSORS

Operational Sponsors

Provide equity AND know how for the development of the project

Get returns on their investment, AND profit from their operational involvement

Financial

Fairly recent participants

Traditionally funds came from operational and public sponsors

No other role than financial

Public

Focuses on growth and job creation rather than just profit

Where public administration is involved we call this Public Private Partnership

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Lenders

Typically project finance deals are **highly leveraged** (debt can be over 90%)

TWO MAIN CATEGORIES OF FUNDERS

Banks

(Traditionally the dominant funders)

Project finance loans are large so they need to prepare a syndicate of banks to end money for the construction

Guaranteed by all the assets of the SPV

Bond Investors

(Growing influence)

Relatively new investors

Project bonds are guaranteed by the cash flows over the life of the project

Looking for long-term investments with stable predictable cash flows. Usually fixed rate with a maturity of up to 40 years

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Operational Contracts

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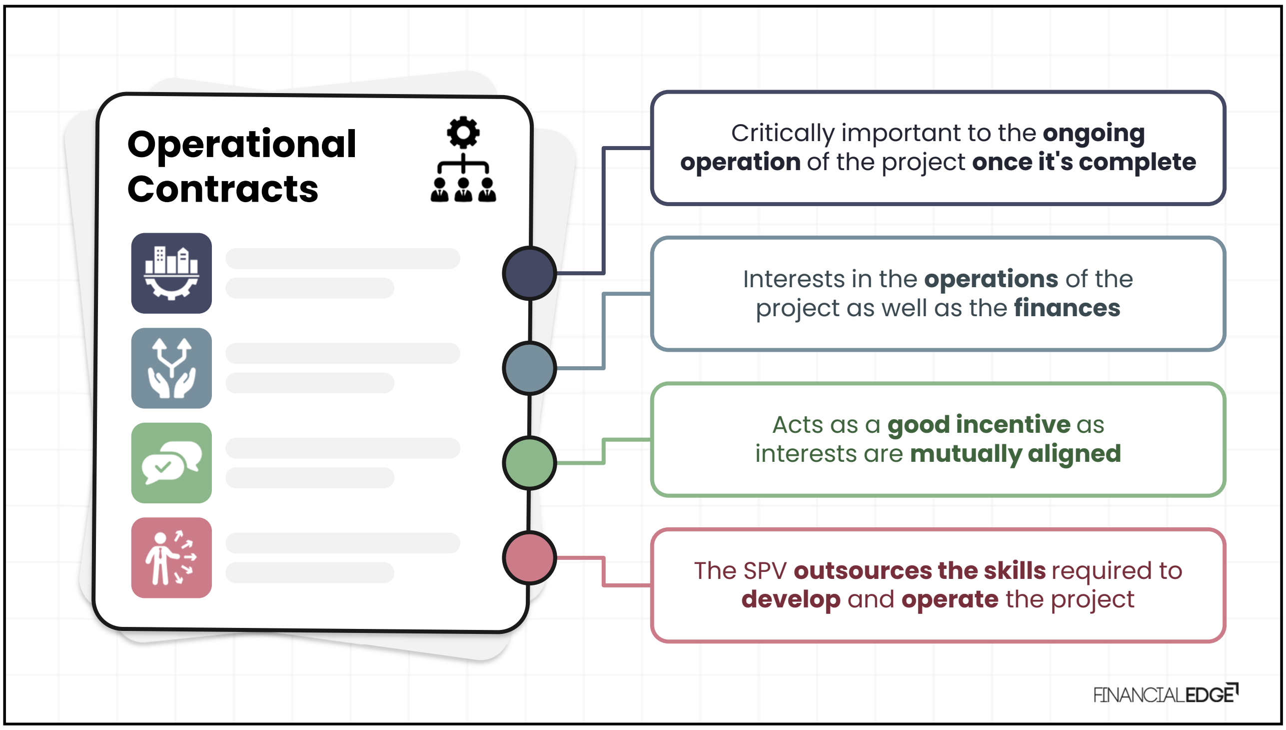
Operational Contracts
Critically important to the ongoing operation of the project once it's complete
Interests in the operations of the project as well as the finances
Acts as a good incentive as interests are mutually aligned
The SPV outsources the skills required to develop and operate the project
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Typical list of operational contracts in a project
Construction Contract
States the budget for the project and the time frame
Operational & Maintenance Contract
When the facility is complete or the construction of the facility is complete
Sales Contract
Purchasers of the end goods/service
Either public e.g. highway
Or small number of big buyers e.g. oil refinery
Supply Agreement
Where there's a key input to the facility
e.g. Agreement with the gas supply to the electricity generation
Concession Agreement
Where project needs approval from public sector e.g. prisons
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Key Contracts

EPC – Engineering, Procurement & Construction

- **Turnkey agreement** to make PP&E available to SPV
- Key **deadlines**, **quality**, and **prices**. Penalties if delivery is late or not to design
- Helps **shift construction risk** from the SPV to the contractor

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Purchasing Agreement

- With **raw material** suppliers
- Stipulate **quality price** and **quantity** on **a put or pay basis**
- Supplier unconditionally **guarantees input** or **pays damages**
- Helps shift supply chain **risk to suppliers**

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Selling Contract

- With **off-taker** or other **third party**
- Known as **take or pay**, selling part or all output
- Stipulates **prices** & **length** of **purchase agreement**
- Helps **shift market risk** to a third party

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Operational Maintenance Contracts (O&M)

- Provides efficient **plant maintenance**
- Predefined **service level agreements**
- Helps transfer **operational risk away** from the SPV

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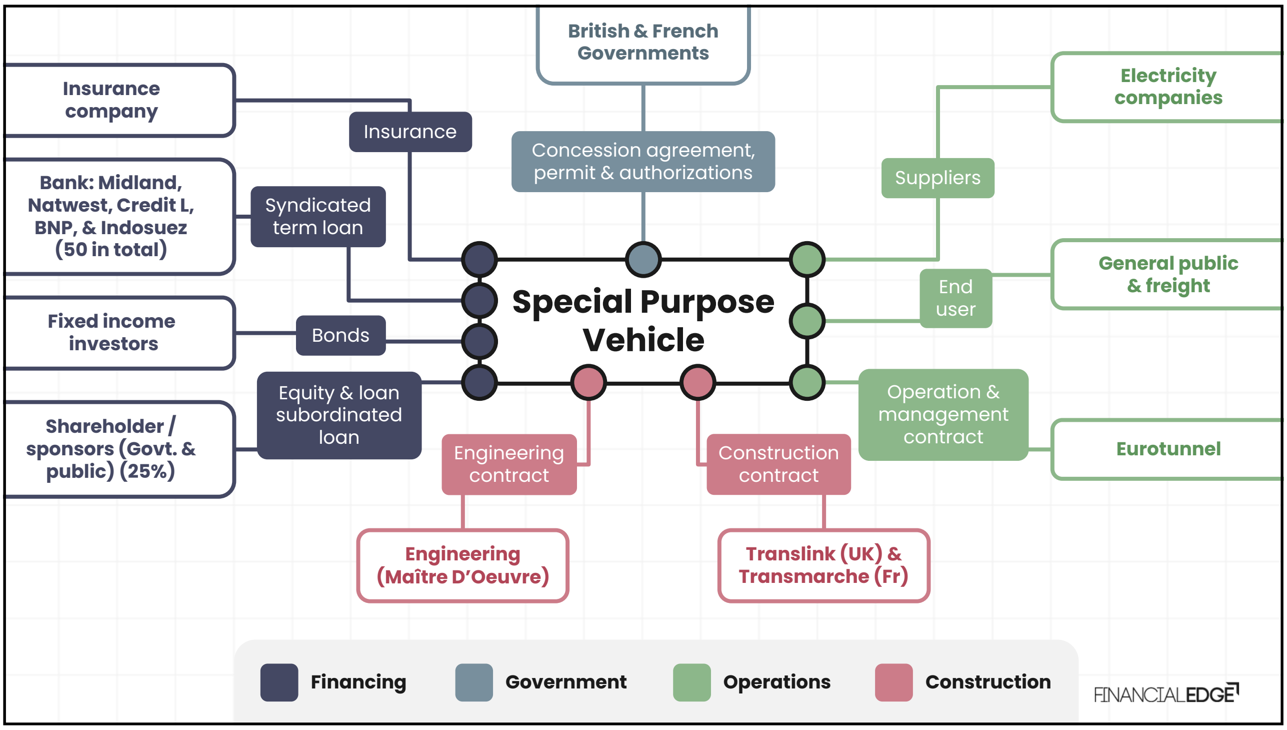
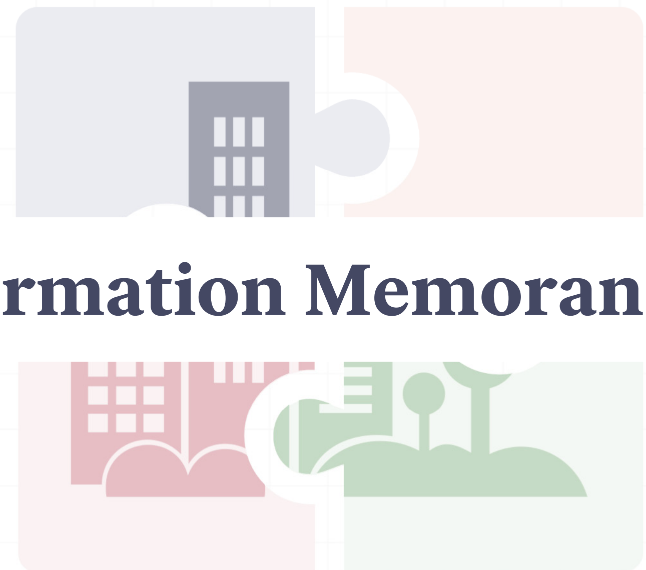
Eurotunnel – Case Study

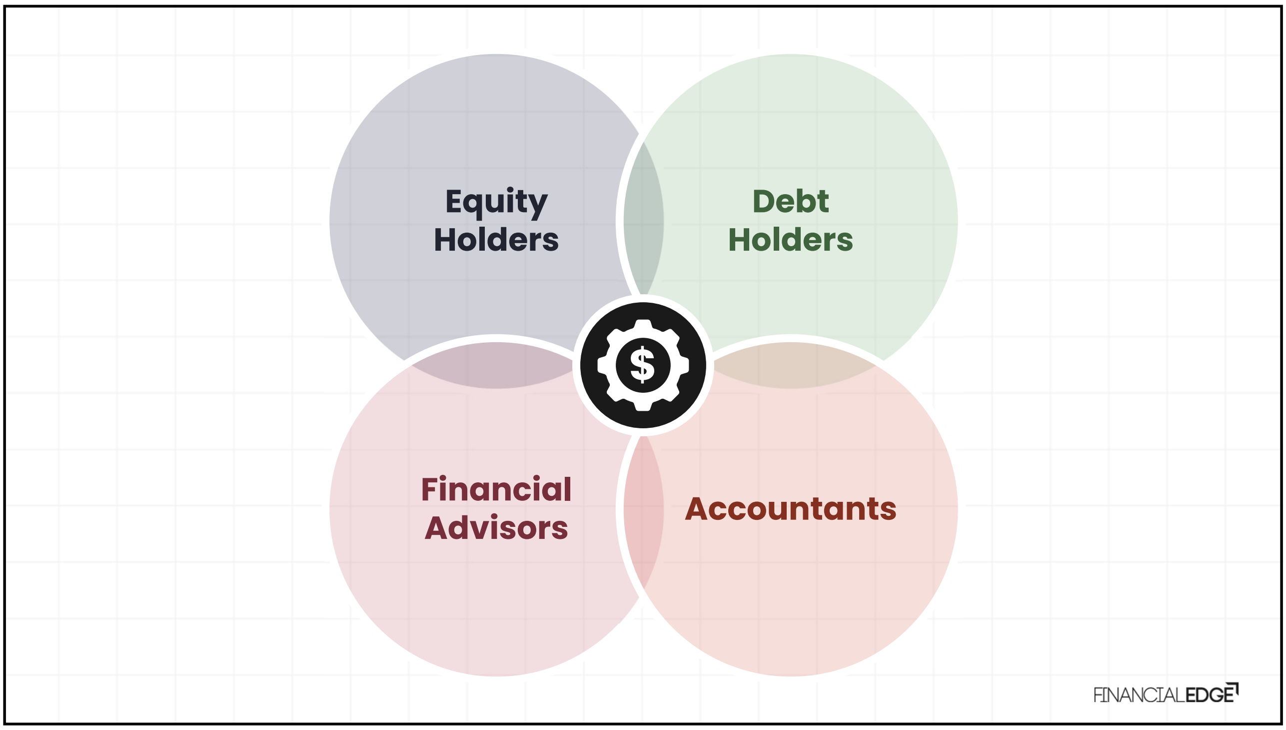


Equity issue	£MM	Timing
Founders	47	Sep. 1986
Private placement	206	Oct. 1986
Public share issue	770	Nov. 1987
Rights issue	566	Nov. 1990
Rights issue	793	May 1994
Unit issue to Bombardier	35	Jun. 1994
Warrants and options	17	Jun. 1994
Founder warrants	48	Jun. 1995
1993 warrants	158	Oct. 1995
1992 warrants	25	Mar. 2000
Bank warrants	37	Mar. 2000
Total	2,702	

Debt issue	£MM
Senior credit facilities	647
Junior credit facilities	6,800
Euro. Investment bank	300
ECSC	200
Co-financing facilities:	
Euro. Investment bank	1,000
Credit National	2,000
Total	10,947



Information Memorandum


Equity
Holders
Debt
Holders
$
Financial
Advisors
Accountants
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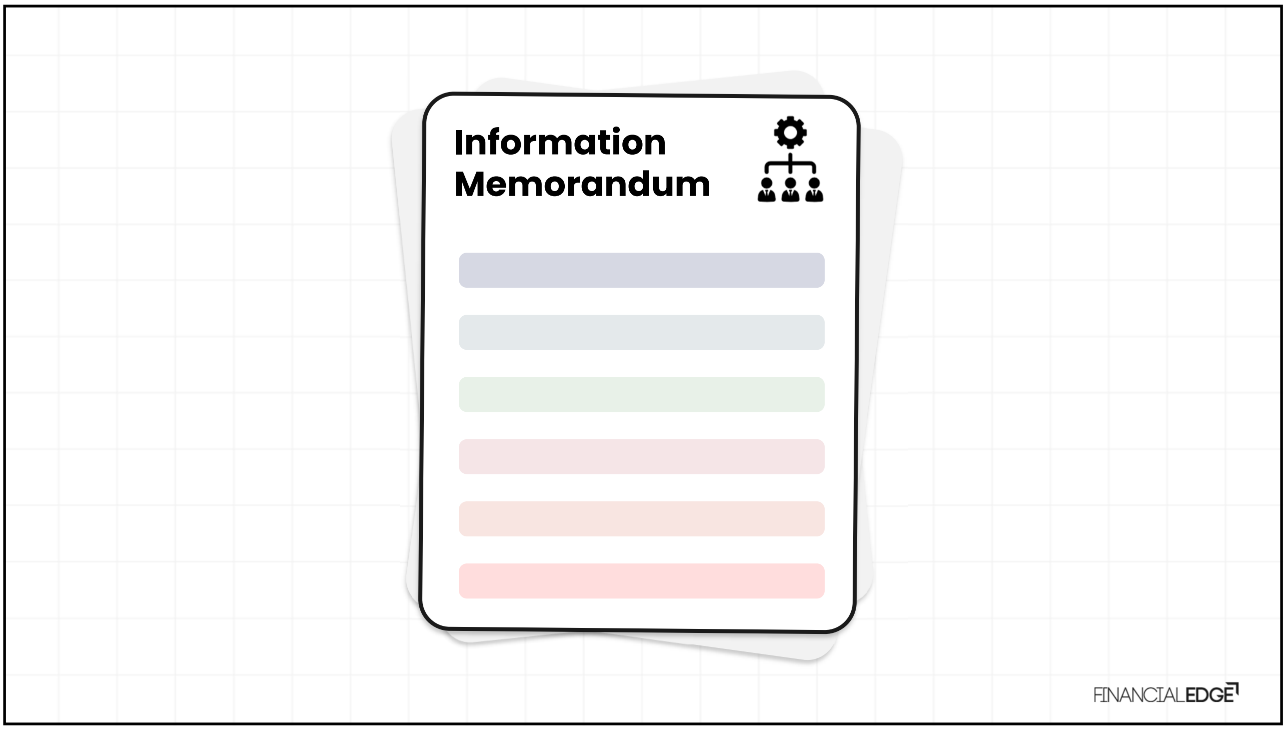
Information
Memorandum
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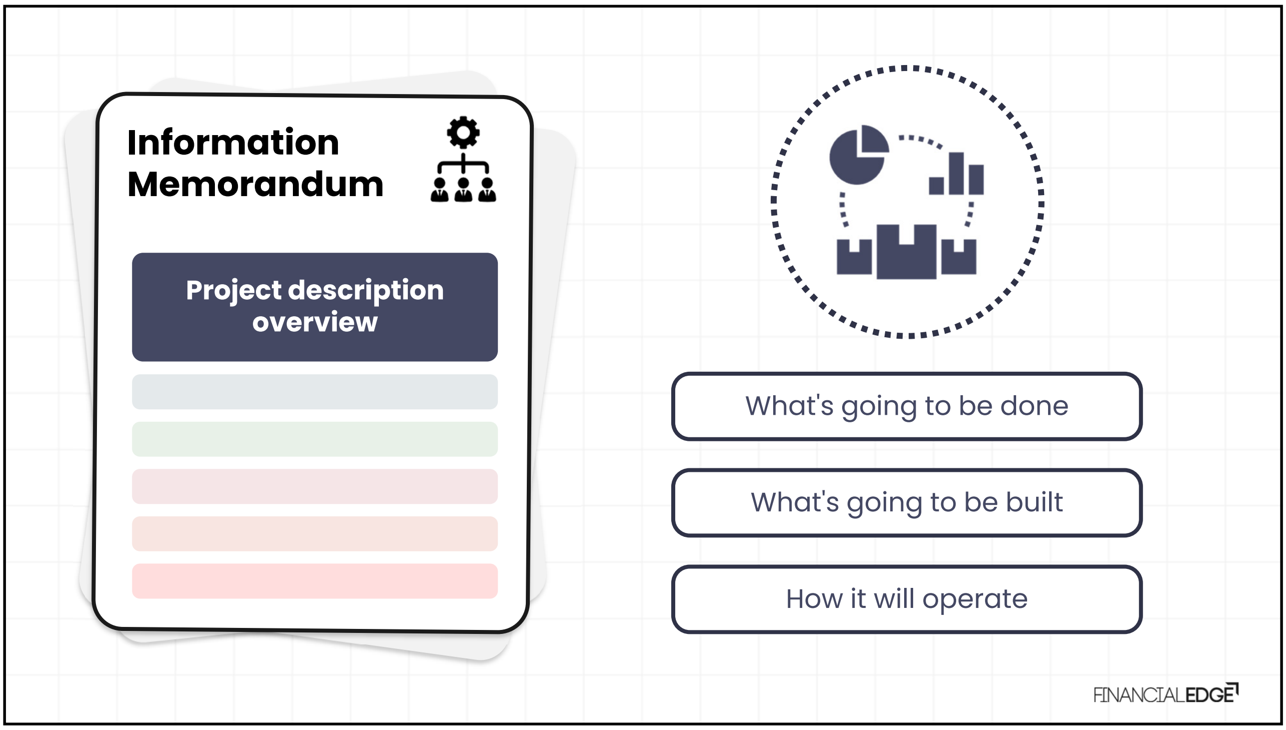
Information Memorandum
Project description overview
What's going to be done
What's going to be built
How it will operate
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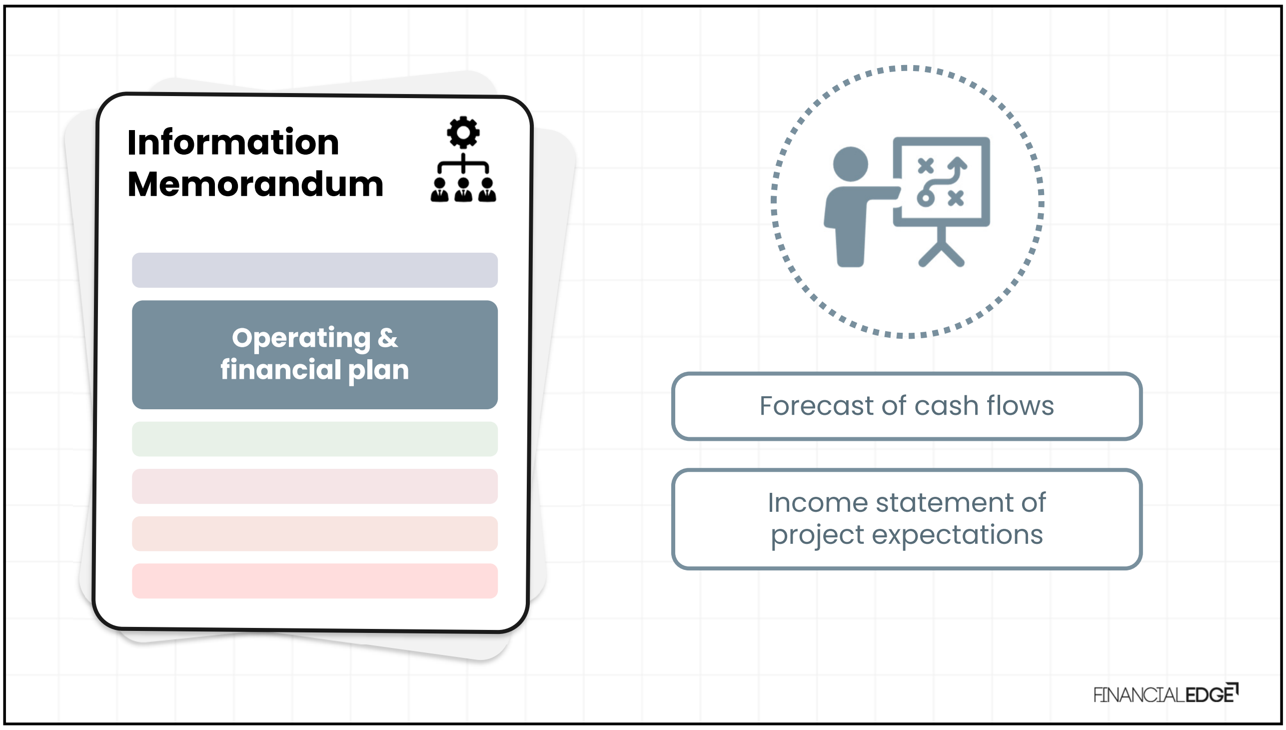
Information Memorandum
Operating & financial plan
Forecast of cash flows
Income statement of project expectations
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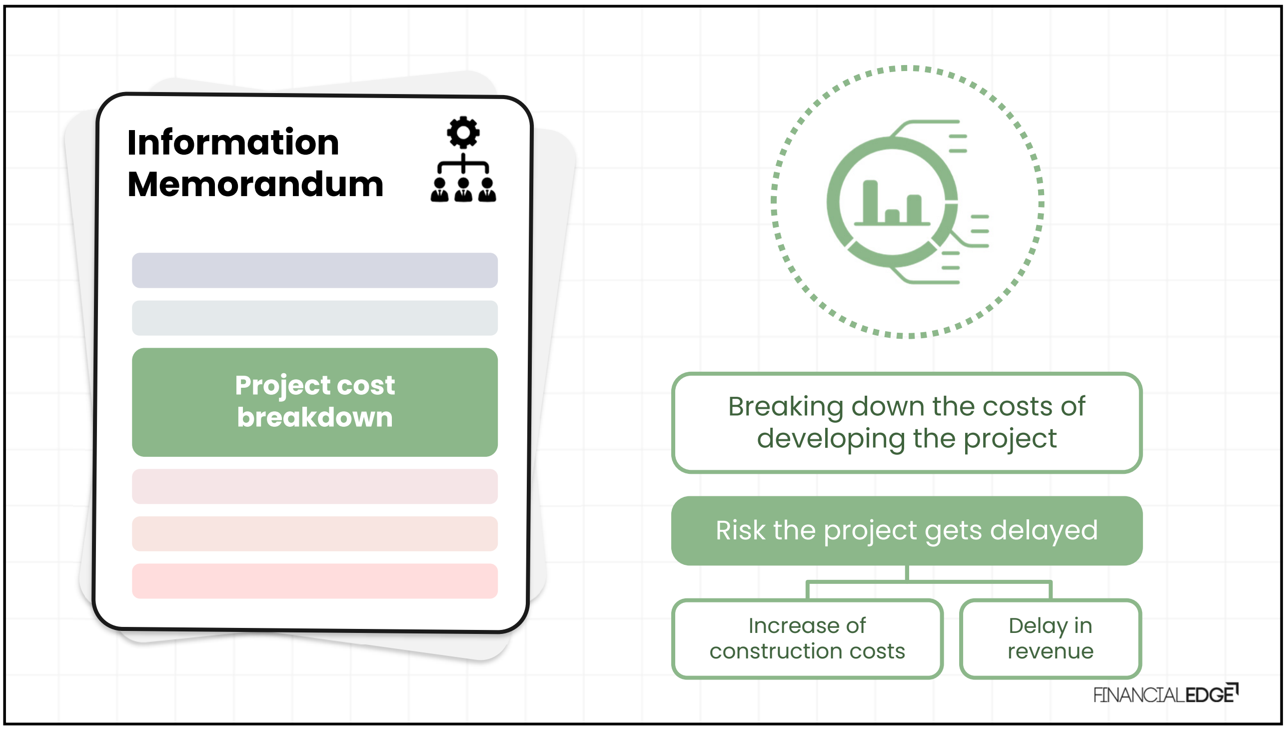
Information Memorandum
Project cost breakdown
Breaking down the costs of developing the project
Risk the project gets delayed
Increase of construction costs
Delay in revenue
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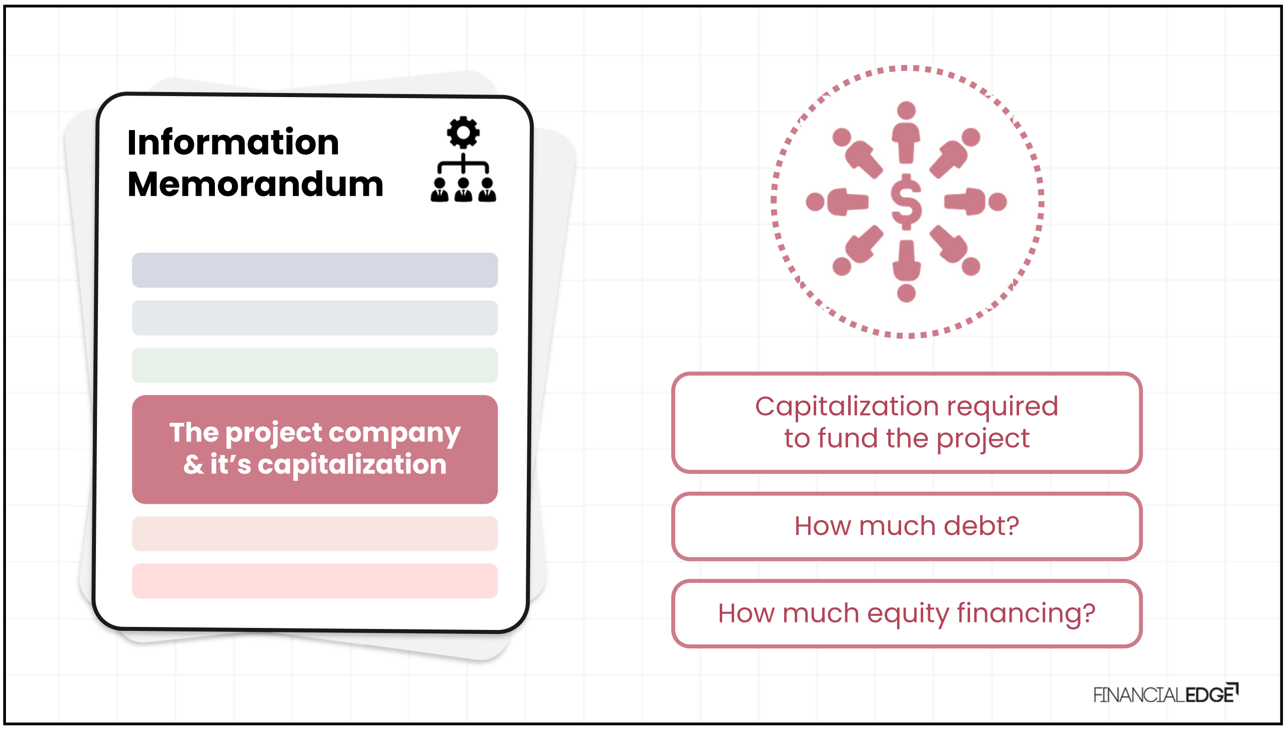
Information Memorandum
The project company & it's capitalization
Capitalization required to fund the project
How much debt?
How much equity financing?
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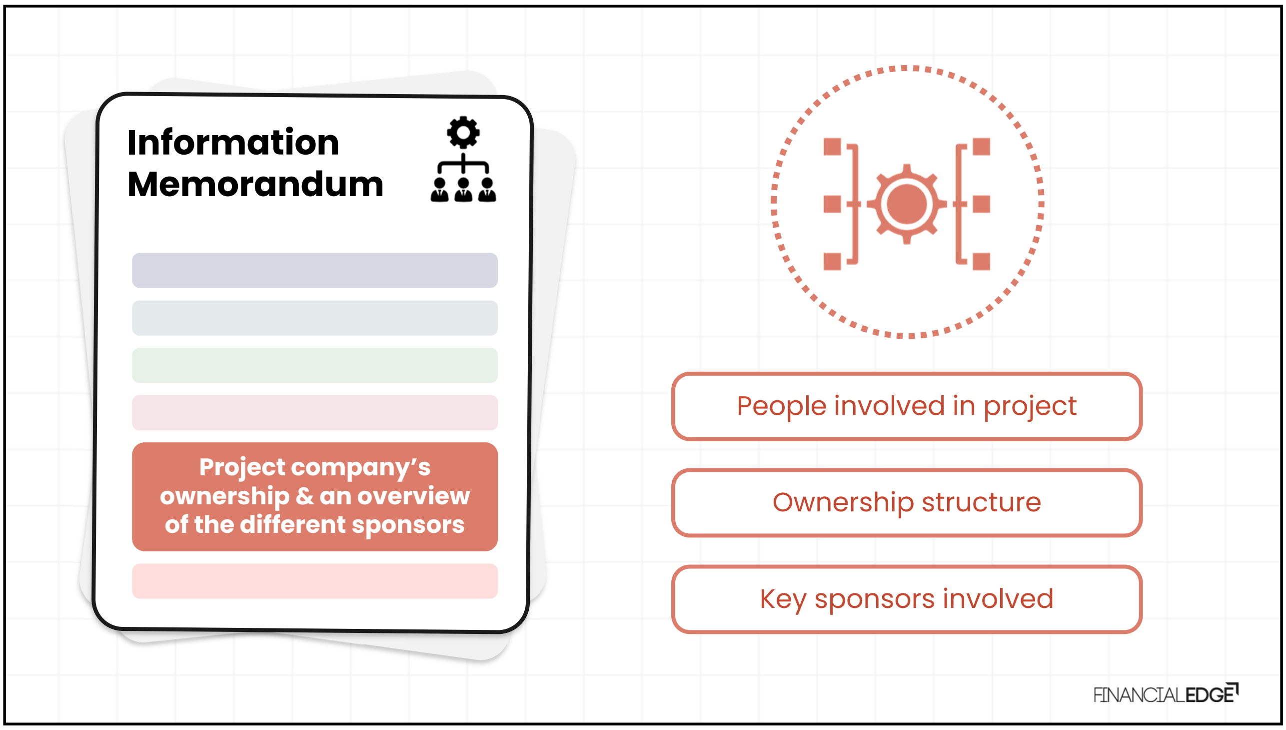
Information Memorandum
Project company's ownership & an overview of the different sponsors
People involved in project
Ownership structure
Key sponsors involved
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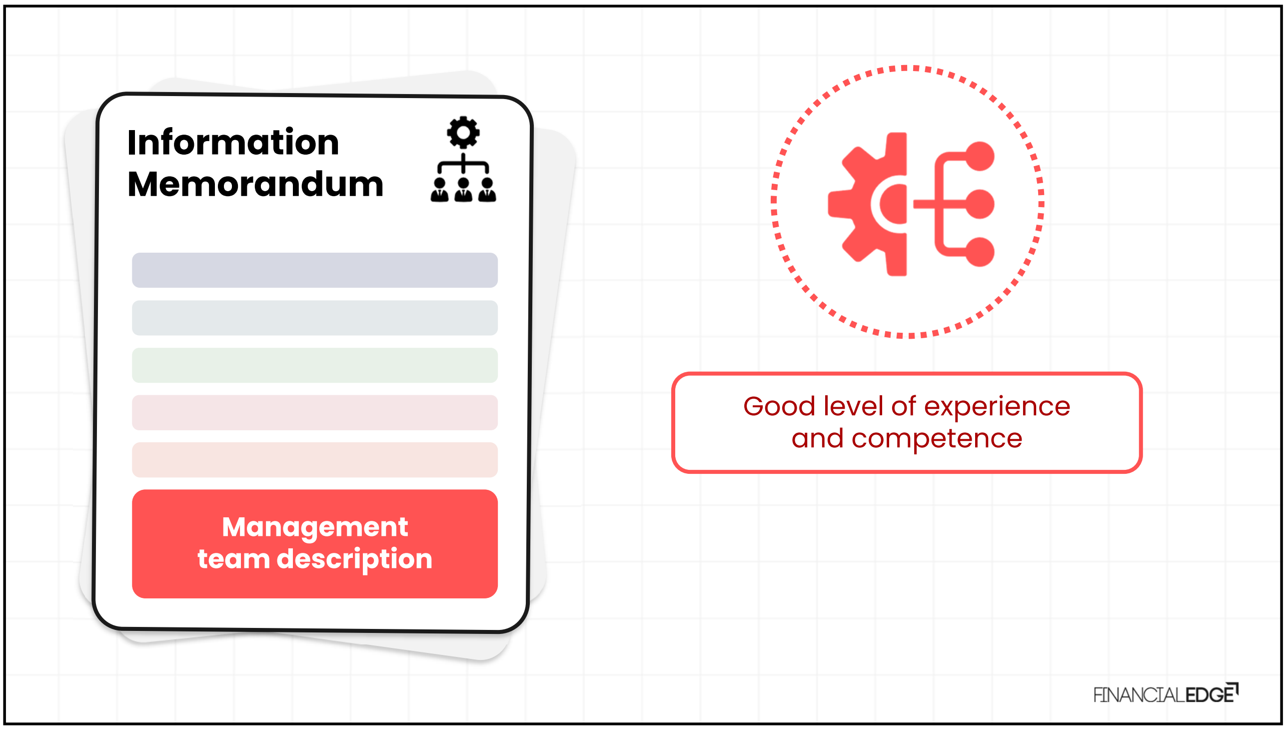
Information Memorandum
Management team description
Good level of experience and competence
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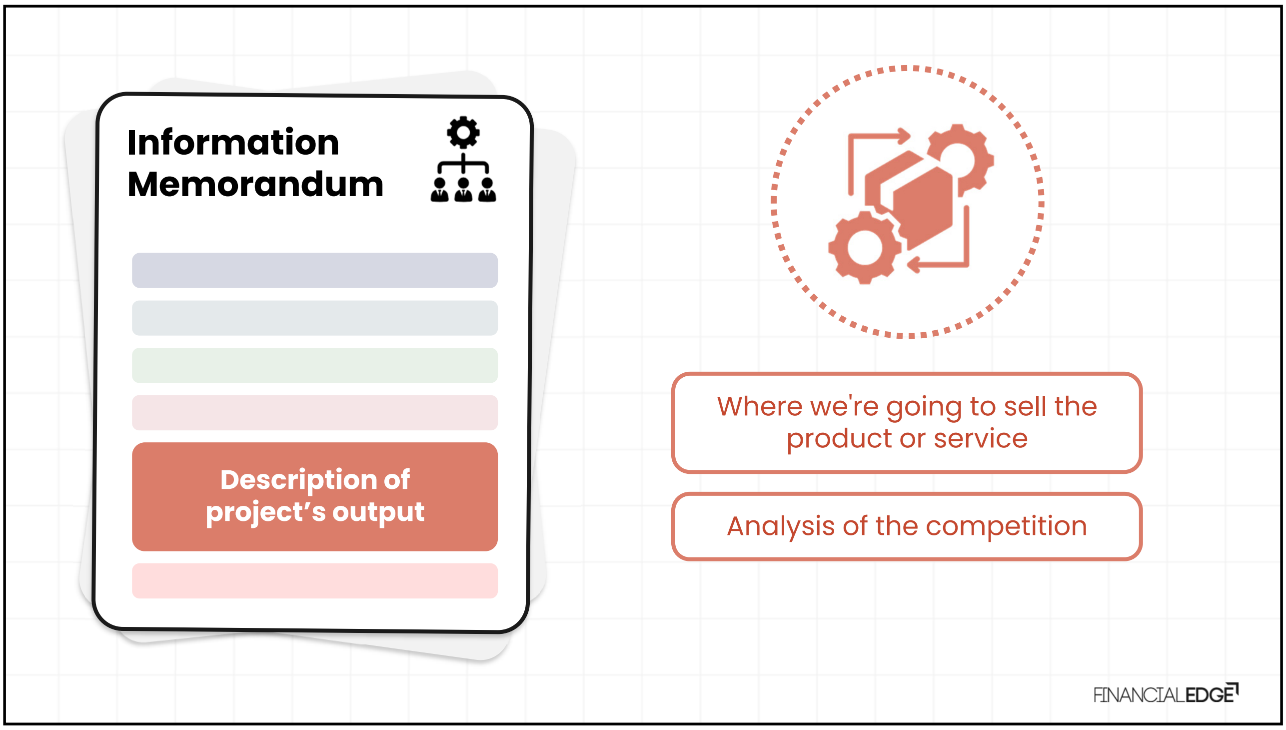
Information Memorandum
Description of project's output
Where we're going to sell the product or service
Analysis of the competition
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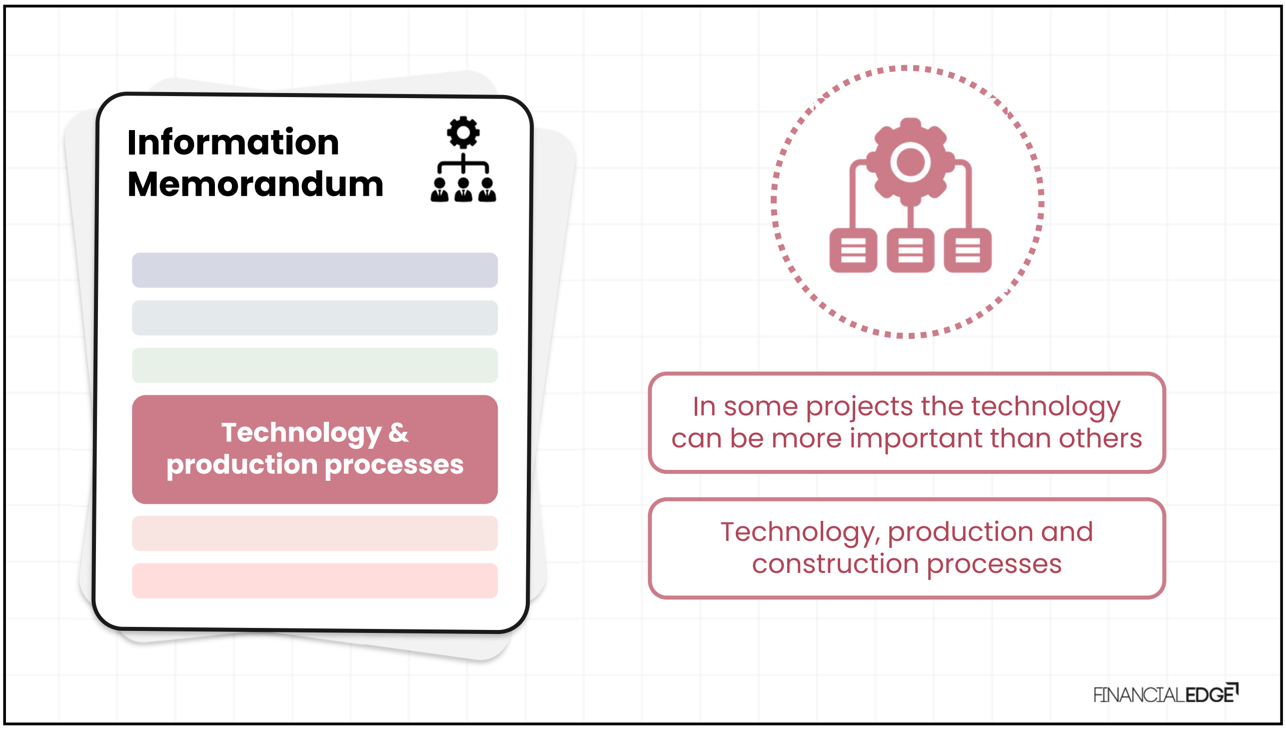
Information Memorandum
Technology & production processes
In some projects the technology can be more important than others
Technology, production and construction processes
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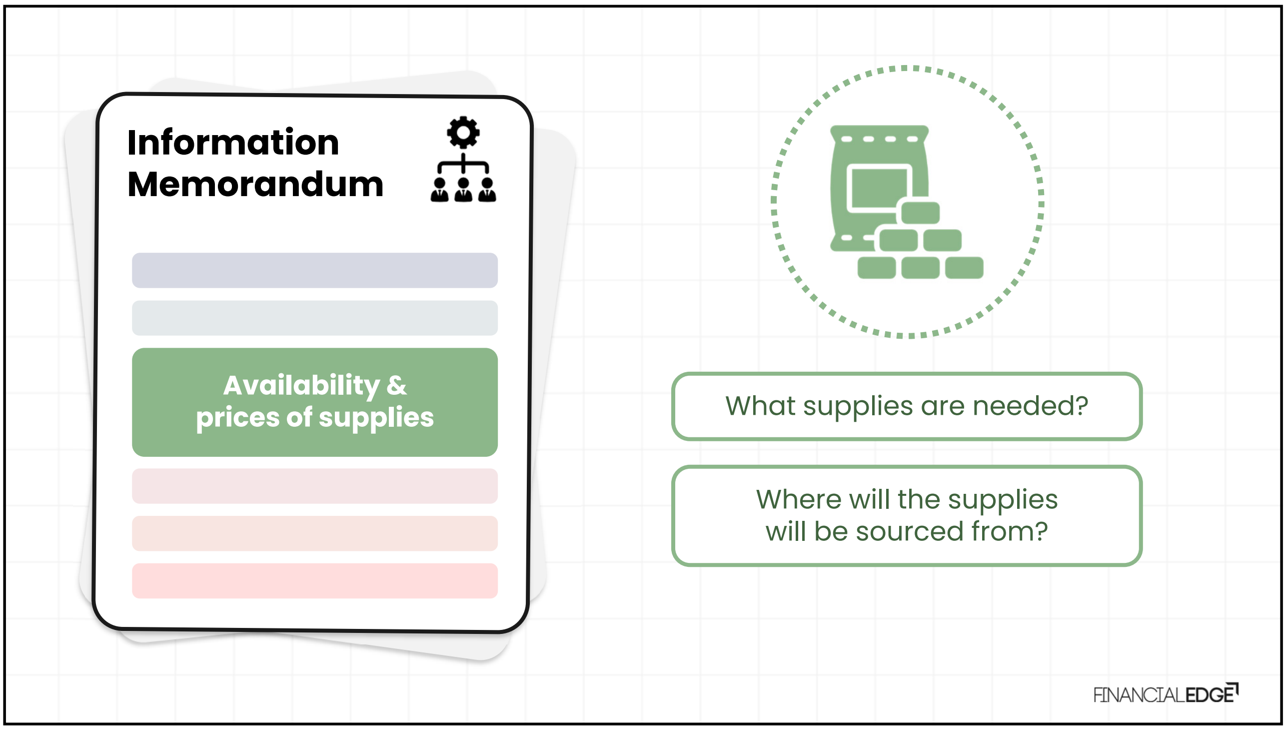
Information Memorandum
Availability & prices of supplies
What supplies are needed?
Where will the supplies will be sourced from?
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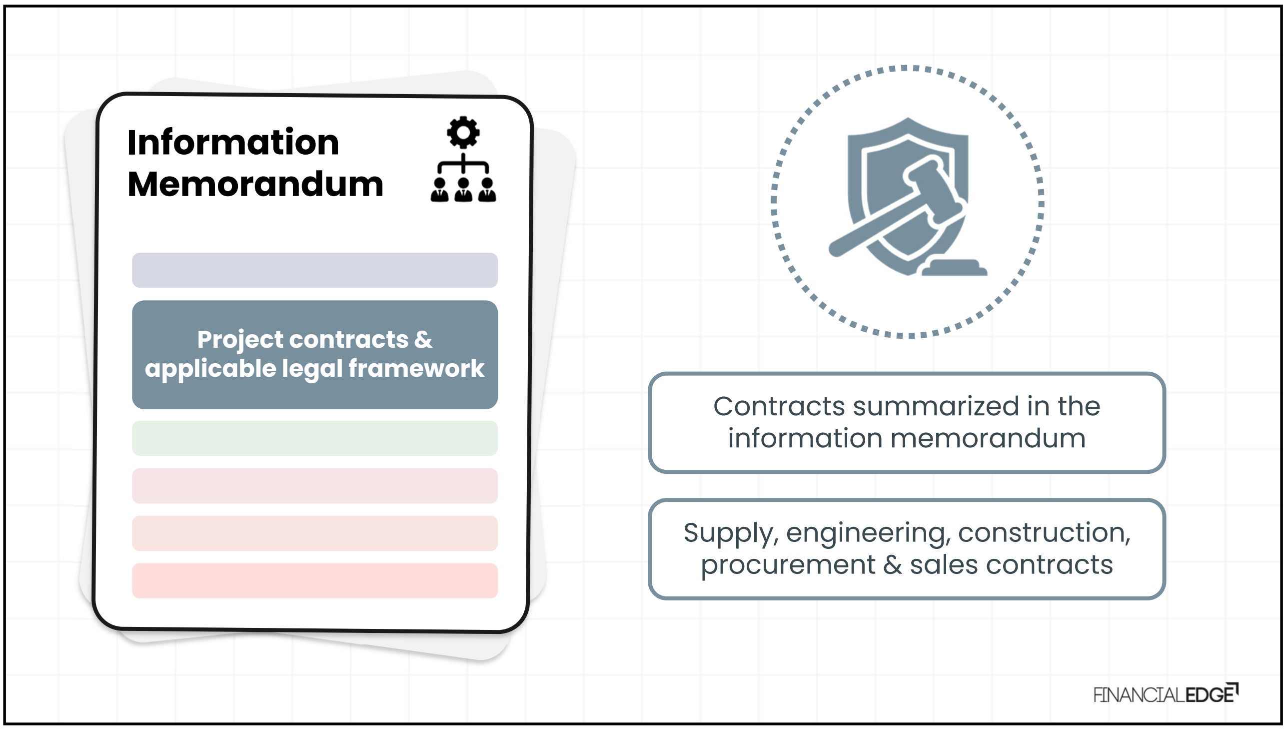
Information Memorandum
Project contracts & applicable legal framework
Contracts summarized in the information memorandum
Supply, engineering, construction, procurement & sales contracts
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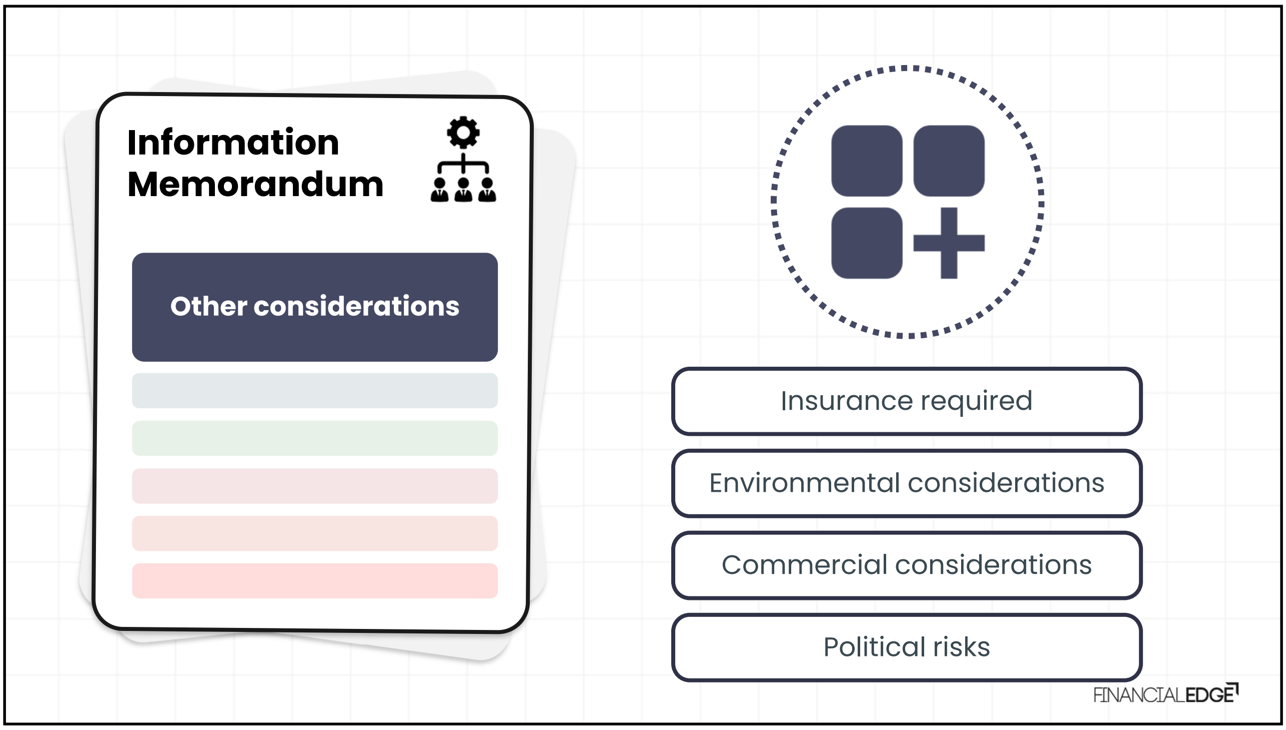
Information Memorandum
Other considerations
Insurance required
Environmental considerations
Commercial considerations
Political risks
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